

US Partnerships With Foreign Partners: Navigating Withholding, Informational Reporting and Payment Requirements

WEDNESDAY, NOVEMBER 16, 2016, 1:00-2:50 pm Eastern

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US Partnerships With Foreign Partners

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Overview

- I. Introductions
- II. Income Taxation of Partnerships with Foreign Partners
- III. Blocker Corporations & Foreign Partnerships
- IV. Partnership Chapter 3 Withholding and Reporting
- V. Partnership Chapter 4 Withholding and Reporting
- VI. Filing Requirements

Income Taxation

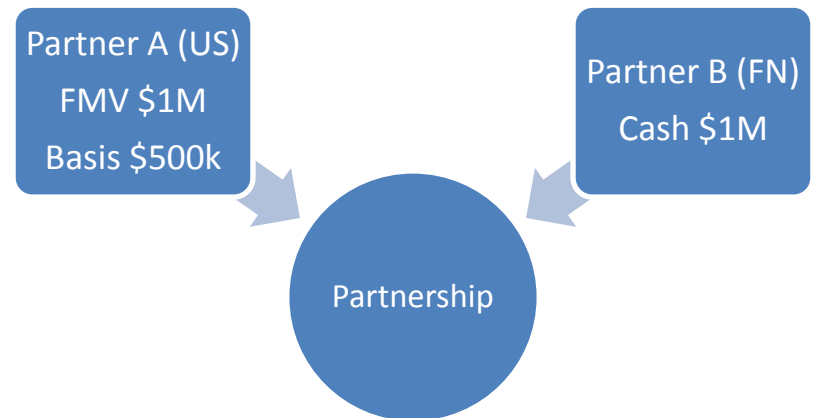
- Aggregate vs. Entity Theory
- Subchapter K
- What is a “Foreign Partner”?
- Initial Concepts

Income Taxation

Taxation on Formation

- Section 721
- Note: Temp. Reg 1.897-6T(a)(3)

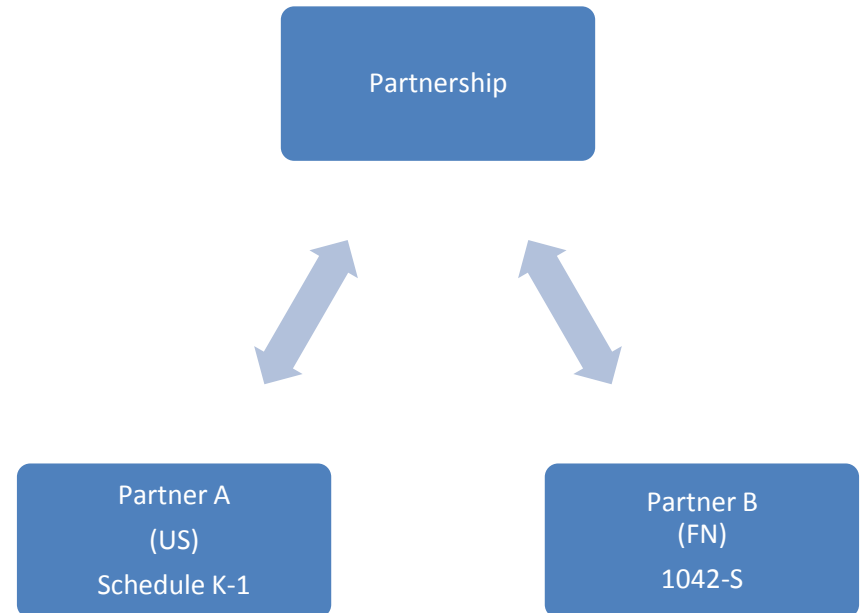
What if asset is real estate?



Income Taxation

Taxation During Operation (Generally)

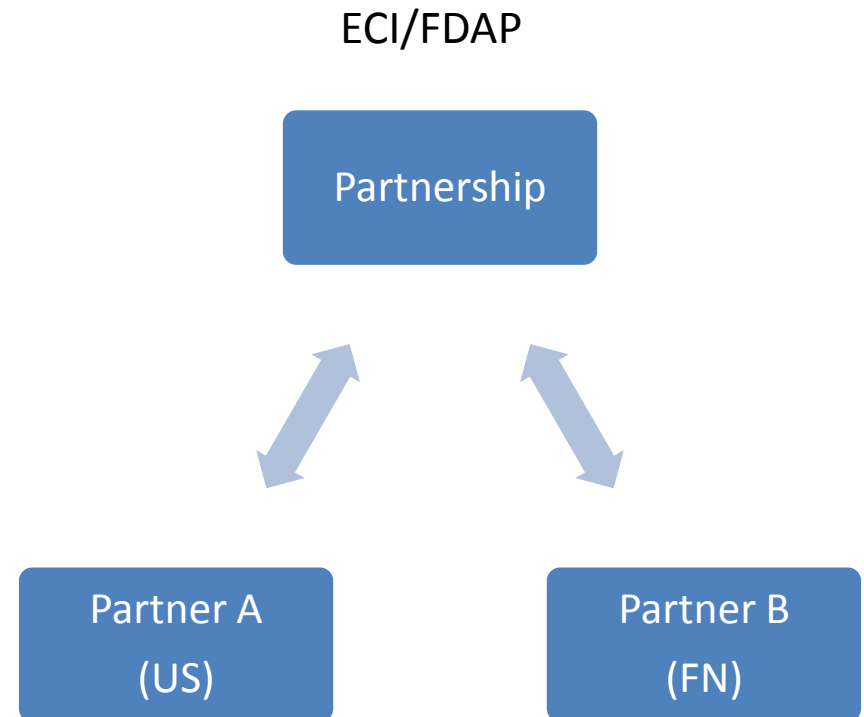
- General Rule: 871(a)
- Section 875: Engaged in Trade or Business
- Withholding
 - 39.6% Foreign Individual (ECI)
 - 35% Foreign Corporation (ECI)
 - 30% NRA (FDAP Income)



Income Taxation

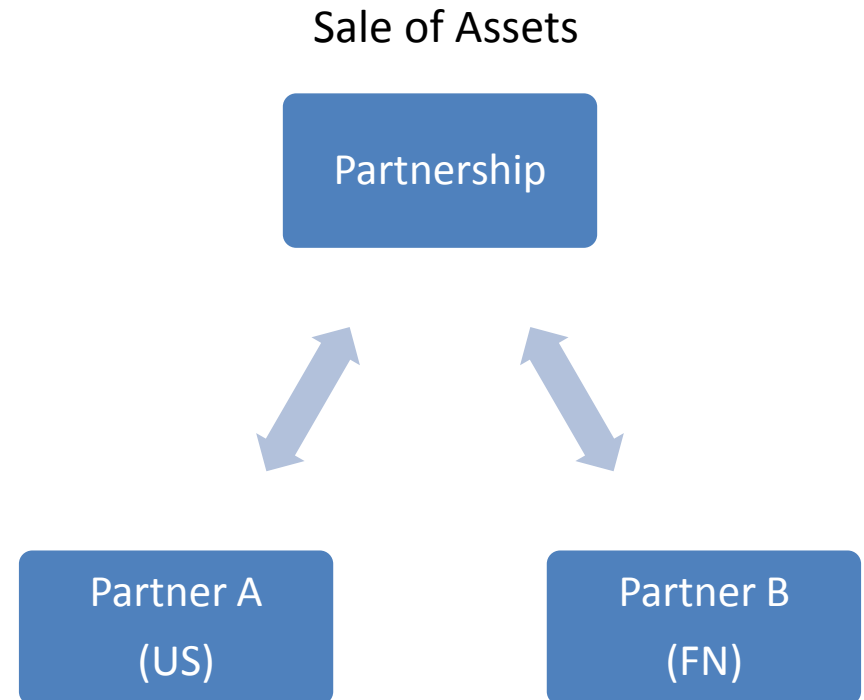
Taxation During Operation (Specifics)

- Effectively Connected Income (ECI)
- FDAP Income
- Withholding regimes



Income Taxation

- Distributions from Partnerships
 - Section 731: Generally tax free to extent of outside basis
 - Be aware of 1.897-6T(a)(3)
- Sale of Partnership Interest
 - Considered sale of capital asset
 - RR 91-32



Blocker Corporations & Foreign Partnerships

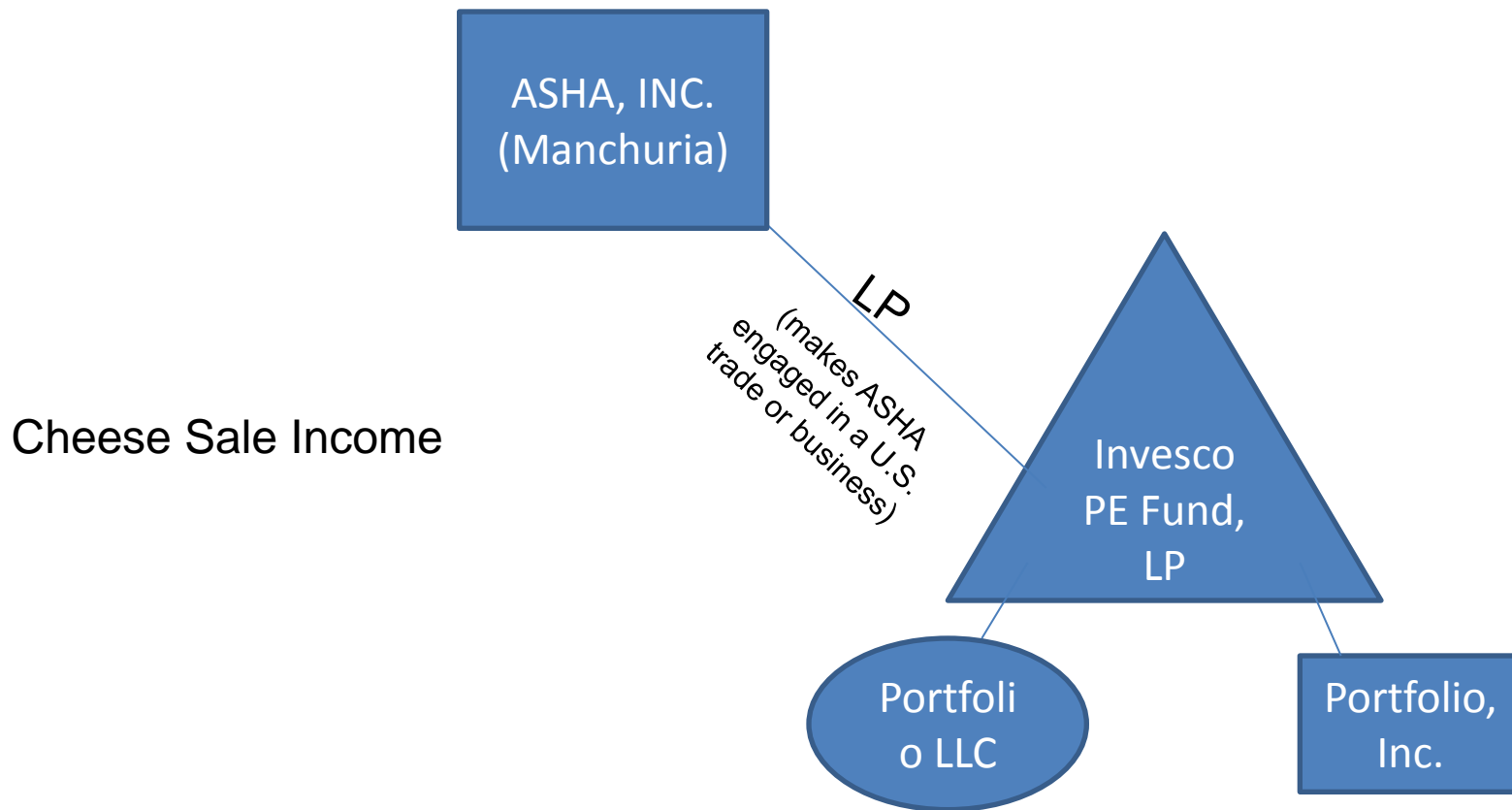
- All income earned by any individual or entity is either U.S. source income or non-U.S. source income § § 861-865
- Owners of flow-through entities, including partners in partnerships, are deemed to be engaged in the trade or business the partnership is engaged in. §875(1)
- A flow-through entity will also attribute a permanent establishment to its holders, which can ruin structures that rely on treaty planning
- If a partner is engaged in a U.S. trade or business, all of the partner's non-FDAP income is treated as ECI and becomes subject to tax at graduated rates §864(c)(3)
- This is especially important for investment funds. Although trading in securities does not make one engaged in a U.S. trade or business, investment funds face significant risks. (e.g. being deemed to be engaged in a U.S. trade or business of lending money) Private equity fund investments in particular require careful planning

Blocker Corporations & Foreign Partnerships

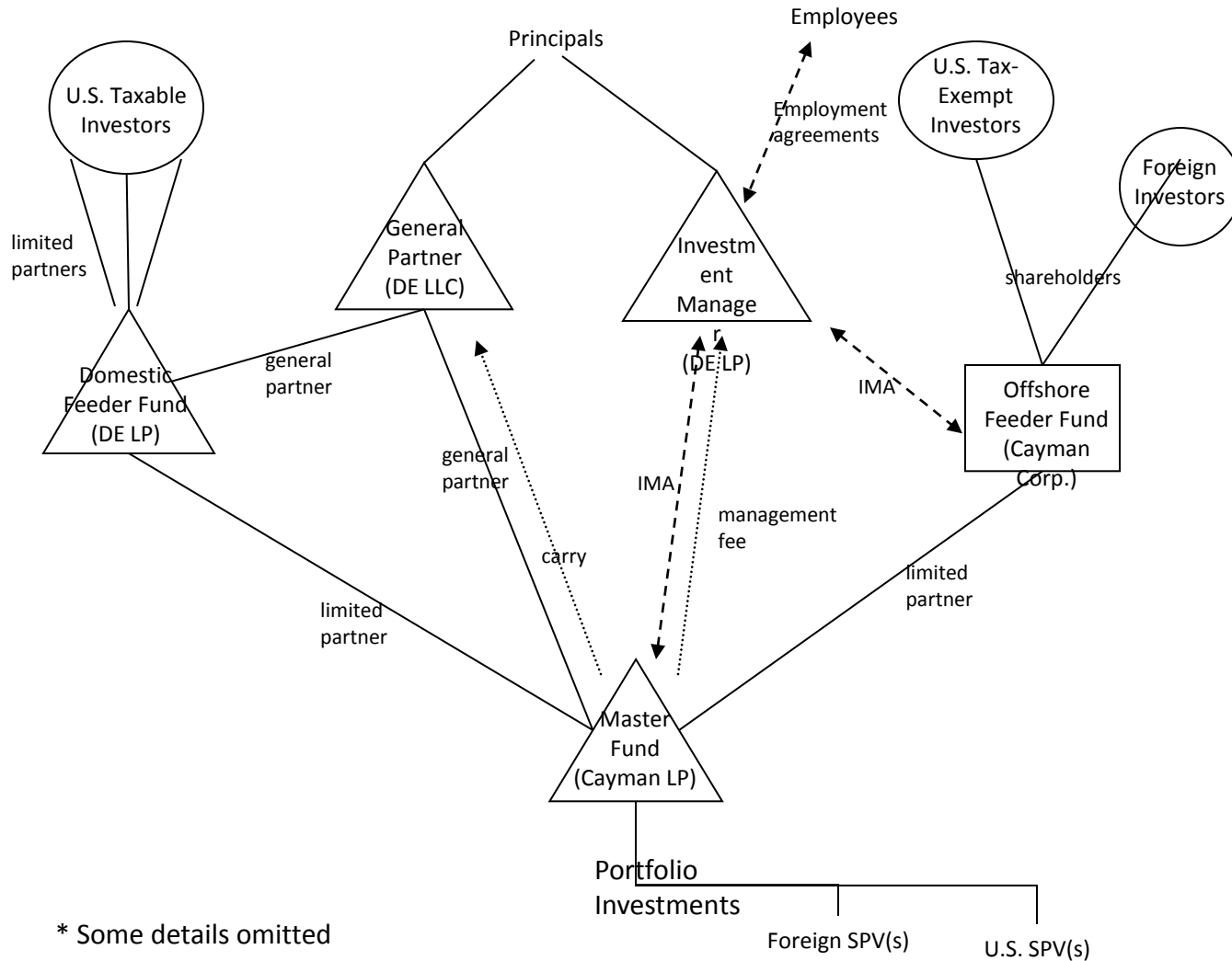
- Blocker Corporations “cut off” the attribution in §875(1) and pay dividends to the foreign shareholder
- Both domestic and foreign partnerships can be engaged in a U.S. trade or business. The status will flow through regardless of how many pass-through entities are in a chain or their respective jurisdictions.
- Foreign partnerships face additional requirements for Chapter 4 withholding purposes

ASHA, INC. exports fancy cheeses to the United States.

Title to the cheese passes in the United States. ASHA also invests spare funds in Invesco, a U.S. Private Equity Fund.



Typical Hedge Fund Structure



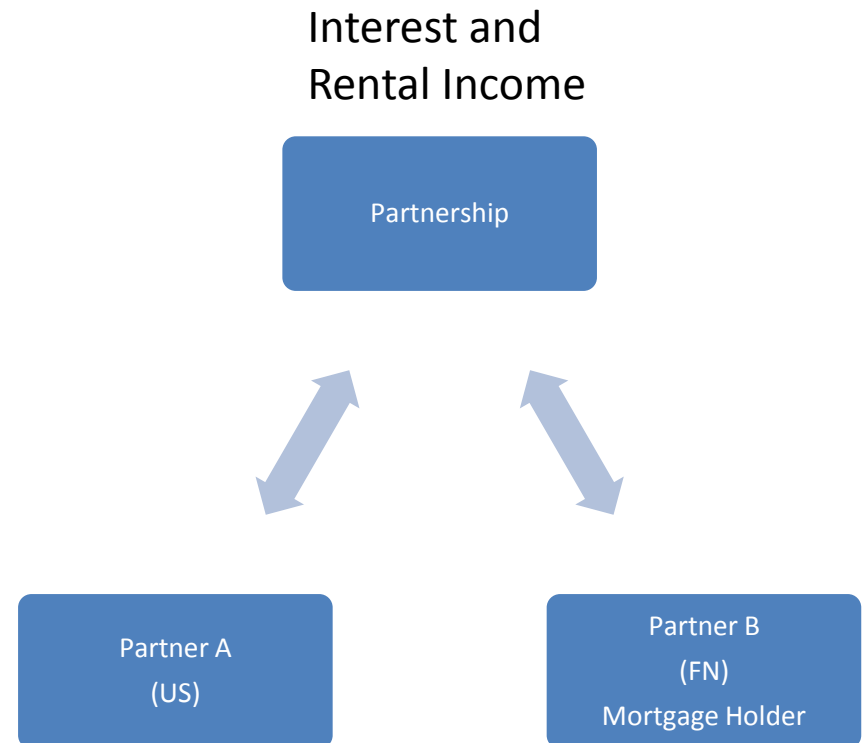
Chapter 3 Withholding & Reporting

- U.S. Source Income
- Person/Entity responsible for withholding
 - LLC/LP/GP-US/Non-US
- Amount Subject to Withholding
- Withholding rates

Chapter 3 Withholding & Reporting

FDAP Income (assumes non-ECI FDAP)

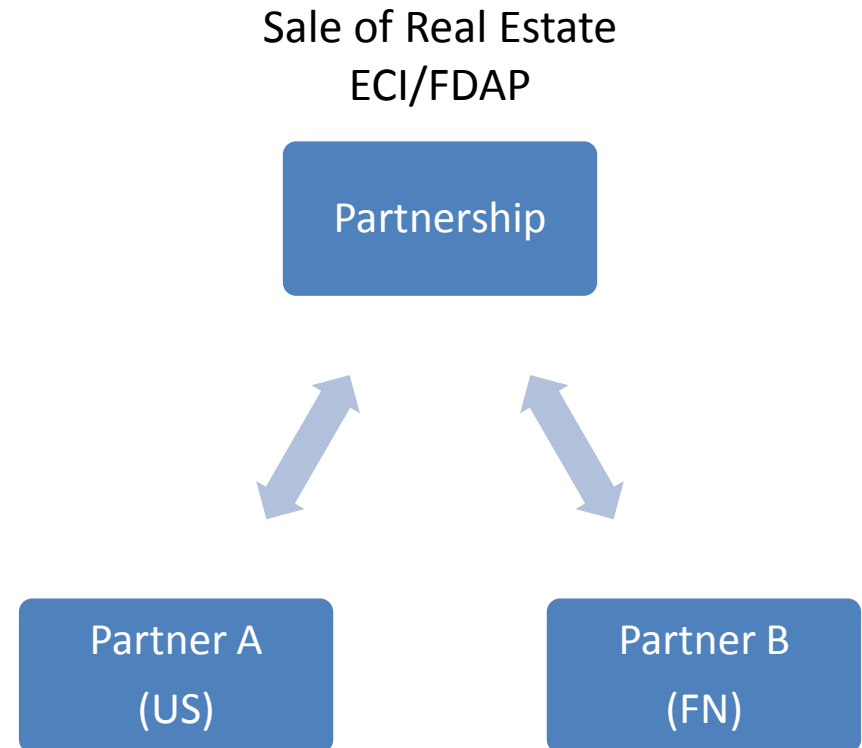
- Applicable Sections: 1441-1442
- Withholding Agent: Domestic Partnership
- Withholding Rates: 30% unless treaty rate applies



Chapter 3 Withholding & Reporting

FIRPTA Income (Non-ECI)

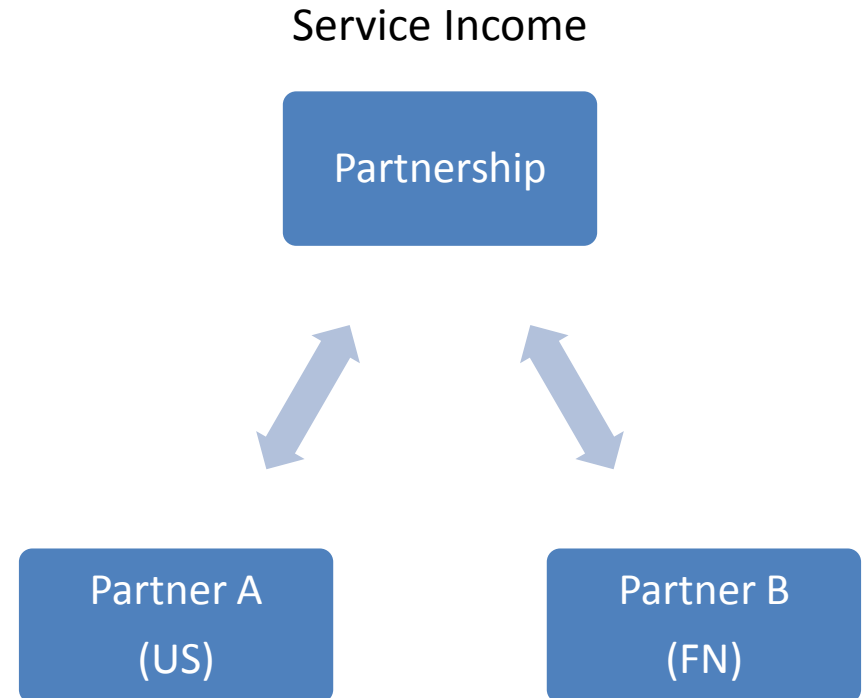
- Applicable Section: 1445
- Withholding Agent: Partnership
- Withholding Rates:
 - 20% of gain for individual partners
 - 35% of gain for corporate partners
- Interplay with 1446



Chapter 3 Withholding & Reporting

Service Income

- Initial Inquiry: Who is performing the services?
- Applicable Section:
- Withholding Agent: Partnership
- Withholding Rate:
- Treaty Applicability:



Chapter 3 Withholding & Reporting

Effectively Connected Income

- Applicable Section: 1446
- Withholding Agent: Partnership
- Withholding Rates:
 - 39.6% for foreign individual partners
 - 35% for foreign corporate partners

Chapter 3 Withholding & Reporting

Treaty Modifications

- What are they?
- Results of Modification: Reduced Rate or Elimination of Withholding
- Key Concepts and Articles

Chapter 4 Withholding & Reporting: A Trap for the Unwary

- The Hiring Incentives to Restore Employment Act (P.L. 111-147) introduced a second set of withholding requirements with respect to foreign financial institutions and other foreign entities
- Chapter 4 withholding is commonly known as FATCA withholding
- Under Chapter 4, a withholding agent is required to withhold on any withholdable unless certain documentation is provided
- Chapter 4 withholding applies when withholdable payments are made by a withholding agent to accounts at certain foreign financial institutions (“FFIs”)

Chapter 4 Withholding & Reporting

Definitions:

- “Withholding Agent” is defined broadly, and generally means any person with control, receipt, custody, disposal, or payment of any withholdable payment. a withholding agent is required Treas. Reg. 1.1473-1(d)(1)
- “Withholdable Payment” is generally a payment of FDAP income (e.g. interest, dividends, rents). Treas. Regs. 1.1471-1(b)(136) & 1.1473-1(a)
- The payment of effectively connected income (income generated by being engaged in a trade or business in the United States) is generally not a withholdable payment. Treas. Reg. 1.1473-1(a)(4)

Chapter 4 Withholding & Reporting

Definitions, Continued:

- “Account” includes equity ownership in entities (e.g. investment funds), in addition to depository and custodial accounts. Treas. Reg. 1.1471-5(b)
- “Foreign Financial Institution” includes foreign banking businesses, insurance companies, and investment entities (among others). Treas. Reg. 1.1471-5(e)
- Investment Entities include the follow doing activities or business for a customer:
 - Trading in money market instruments, foreign currency, etc.
 - Individual or collective portfolio management”
 - Otherwise investing, administering, or managing funds, money, or financial assets on behalf of other persons.” (1.1471-5(e)(4).

Chapter 4 Withholding & Reporting

Key Points

- You should presume that any payment not made to an individual may be subject to Chapter 4 withholding, both because of the broad definition of what constitutes an “account” and the broad definition of what constitutes an FFI
- Chapter 4 withholding can be very different than Chapter 3 withholding. A withholding agent may be required to withhold under Chapter 4 even when an item of income is specifically exempted under Chapter 3

Chapter 4 Withholding & Reporting

Key Points, Continued

- Portfolio interest is not subject to Chapter 3 withholding but is subject to Chapter 4 withholding. Treas. Reg. 1.1473-1(a)(2)(i)(C)
- Chapter 4 withholding is not an additional tax. Additionally, Chapter 4 and Chapter 3 withholding are not duplicative. Treas. Reg. 1.1474-6. Therefore, a withholding agent need withhold only once

Chapter 4 Withholding & Reporting

Intergovernmental Agreements (IGA)

- There are two standard IGAs in place—Model 1 and Model 2
- Generally, payments to a compliant FFI are not subject to withholding
- Under Model 1 IGAs, FFIs are responsible for making reports on their account holders to their national tax authorities, and their national authorities make reports to the IRS. Under Model 2 IGAs, FFIs report directly to the IRS
- Each IGA provides a series of definitions that can modify, expand, or change Treasury Regulations

Chapter 4 Withholding & Reporting

Withholding on Payments to FFIs

- Not all payments need to be withheld
- Note special rules for Non-Financial Foreign Entities (“NFFE”s), including Excepted NFFEs, Deemed Compliant FFIs, and other Rules
- While documentation requirements will often match documentation requirements for Chapter 3 (e.g. W-8BENs, W-8BEN-Es, etc.) Additional documentation will be needed in many cases
- Foreign Financial Entities, e.g. foreign investment funds taxed as partnerships, can become withholding agents. Treas. Regs. 1.871-14T(c)(2)(ii) & (iii)
- Using a “look-through” to individual foreign partners is acceptable in many cases. Treas. Reg. 1.871-14T(c)(2)(i)

Chapter 4 Withholding & Reporting

Example:

- You represent Invesco, LP, a Delaware limited partnership
- Invesco, LP makes investments in portfolio companies that are taxed as partnerships and corporations
- Invesco, LP also invests excess funds in derivatives
- John, Bob, and Sam, all foreign individuals want to “invest” in Invesco, LP, possibly through a SPV. They are unsure whether they want to invest using debt or equity. They are also unsure whether they should use a domestic or foreign SPV
- You are charged with advising Invesco, LP on its withholding obligations and how to structure the investments to minimize Chapter 4 withholding requirements

Filing Requirements

Partnership -

- NRA Withholding
 - Forms 1042/1042-S/1042-T

- ECI Withholding
 - Forms 8804/8805/8813

- Wages/Salaries/Other Compensation
 - Form W-2

- USRPI
 - Forms 8288/8288-A/1099-S

Filing Requirements

Individual/Corporate Partner

- U.S. Individual
 - Form W-9 – Request for Taxpayer ID Number

- Foreign Individual
 - Form W-7 – Application for IRS ITIN
 - Form W-8BEN/W-8BENE/W-8IMY – Certificate of Foreign Status
 - Form 8233 – Personal Service Exemption

- Withholding Certificates re: FIRPTA Exemption

- Income Tax Returns
 - Form 1040-NR & 8833 – Treaty-Based Return Position Disclosure
 - Form 1120-F – U.S. Income Tax Return of a Foreign Corporation